Report

of the

Examination of

Wisconsin Physicians Service Insurance Corporation

Madison, Wisconsin

As of December 31, 2001

TABLE OF CONTENTS

State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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Jorge Gomez, *Commissioner*

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March 6, 2003

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, WI 53702

Commissioner:

In accordance with your instructions, a compliance examination has been made of the affairs and financial condition of:

WISCONSIN PHYSICIANS SERVICE INSURANCE CORPORATION
Madison, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1997 as of December 31, 1996. The current examination covered the intervening period ending December 31, 2001, and included a review of such 2002 transactions as deemed necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations, and included the following areas:

History
Management and Control
Corporate Records
Conflict of Interest
Fidelity Bonds and Other Insurance
Employees' Welfare and Pension Plans
Territory and Plan of Operations
Affiliated Companies
Growth of Company
Reinsurance
Financial Statements
Accounts and Records
Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the independent accountant's work papers. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Independent Actuary's Review

Independent actuaries were engaged under a contract with the Office of the Commissioner of Insurance. They reviewed the adequacy of aggregate life and accident and health reserves, dividends to policyholders, cash flow testing, deferred and uncollected premiums for life insurance, due and uncollected premiums for health insurance, and in force testing. The results of their work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuaries' conclusion.

II. HISTORY AND PLAN OF OPERATION

Wisconsin Physicians Service was created as a division of the State Medical Society in 1946 under the authority of Chapter 148, Wisconsin Statutes. Wisconsin Physicians Service Insurance Corporation ("WPS" or "the company"), a successor non-profit service insurance corporation was incorporated on April 27, 1977, and commenced business the same day.

The company writes direct premium in the state of Wisconsin only. The direct premium written by the company for 2001 is $267,547,898

The company is licensed in two states, Wisconsin and Ohio. The company writes health insurance in Wisconsin only, and assumes health business written in other states by its subsidiary, The EPIC Life Insurance Company (EPIC). A majority of the company's business involves PPO type managed-care products. The company also continues to write indemnity health policies and provides claims administration services for self-insured employers.

In addition to the direct business written, business assumed, and the administration of self-insured groups (ASO), revenues are also generated through administrative contracts with the federal government for TRICARE (formerly known as CHAMPUS) and the Medicare Part A and B programs.

The following table is a summary of premiums written by the company in 2001 as well as the revenues generated by the company's participation in the TRICARE and Medicare programs (see descriptions of the programs below).

2001 Premium Revenue

Direct Premium Written	$267,547,898
Assumed Premium	14,572,463
ASO Revenue:*	
CHAMPUS	62,636,957
Medicare	107,076,223
Private Groups	15,149,921
Total	$466,983,462

* This revenue consists of expense reimbursements for the administering of claims under these programs.

TRICARE

WPS provides administrative services under subcontracts, in total or partially, for three regions of the federal TRICARE plan, which is approximately twenty percent of the entire program. WPS pays benefit dollars for claims using a federal government letter of credit, and receives an administrative fee per claim. The company administered $884 million of CHAMPUS claims in 2001. The TRICARE line of business resulted in net income of $10.8 million for calendar year 2001.

Medicare

WPS administers the Wisconsin, Illinois, Michigan, and Minnesota Part B Medicare claims through a cost-reimbursement contract directly with Centers for Medicare and Medicaid Services (CMS), and the Michigan Part A through a cost reimbursement subcontract. WPS is reimbursed for administrative fees based on a budget set by Medicare each fiscal year. WPS administered $5.7 billion of Medicare claims in 2001. Generally, there is no profit or loss reported by the company for Medicare because it is a cost-reimbursement contract. However, an accounting profit of $479,610 was recorded for 2001 because Medicare does not allow the company to recover a pension credit. WPS' pension plan was fully funded; therefore, no cash was contributed and no expense was recovered, even though a credit was booked.

ASO Business

WPS also provides administrative services for private self-insured groups. WPS administered $357 million of claims for non-government groups in 2001. This line of business resulted in a loss of $3 million for 2001.

III. MANAGEMENT AND CONTROL

Board of Directors

The board of directors consists of 15 members. One-third of the directors are elected annually to serve a three-year term. Officers are appointed at the board's annual meeting. Members of the company's board of directors may also be members of other boards of directors in the holding company group. The board members currently receive $500 per meeting for each board and committee meeting attended plus $250 for any additional meetings attended in a day, limited to $750/day. The chairman of the board receives a $20,000 annual retainer.

Name and Residence	Principal Occupation	Term Expires
Marla Ahlgrimm, R.P Madison, WI	Founder and Chairman Madison Pharmacy Associates, Inc.	2003
Jeffrey Allen, M.D. Rubicon, WI	Family Practice Physician Hartford Parkview Clinic	2003
Brad Anderson Lake Mills, WI	Human Resource Consultant Partnerships in Human Resources	2003
William Bathke Monona, WI	Executive Vice President and COO Wisconsin Physicians Service Insurance Corp.	Ex officio
John Brandabur, M.D. Madison, WI	Internal Medicine Physician Associated Physicians, LLP	2004
Marvin Brickson, Vice Chairman Madison, WI	Retired President and Executive Secretary Madison Federation of Labor, AFL-CIO	2004
Timothy Flaherty, M.D. Neenah, WI	Retired Radiology Assoc. of Fox Valley, S.C.	2004
Edwin Hill, Jr. Asst Treasurer Madison, WI	Retired Vice President Anchor Bank	2004
Leland Kauth Wisconsin Rapids, WI	Public Education Administration Consultant	2003
James Lord, D.D.S. Middleton, WI	Practicing Dentist Independent Practice	2005
John Matthews Madison, WI	Executive Director Madison Teachers, Inc.	2005
John McGloin, M.D. Treasure Island, FL	Retired Surgeon Thoracic Medicine	2004
Eugene Nordby, M.D., Chairman Madison, WI	Orthopedic Surgeon, Professor UW Medical School	2005

James Riordan Madison, WI	President and CEO, WPS Wisconsin Physician Service Insurance Corp.	Ex officio
David Vogel, Secretary Stoughton, WI	Civil Engineer and President, Vogel Bros. Building Co.	2005

Officers of the Company

The officers appointed by the board of directors and serving at the time of this examination are as follows:

Name	Office	Compensation
James Riordan	President and CEO	$ 943,681*
David Vogel	Secretary	7,000
William Beisenstein	Treasurer	190,558*

* Company started a Supplemental Executive Retirement Plan in 2001 and the compensation listed includes amounts to catch-up for all years of service.

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

Executive Committee
Eugene Nordby, MD, Chair
Marvin Brickson
James Riordan
David Vogel
William Bathke
Edwin Hill, Jr
Brad Anderson
Leland Kauth
John Matthews

Audit Committee
Leland Kauth, Chair
Jeffrey Allen MD
Edwin Hill Jr
Eugene Nordby
James Lord, DDS

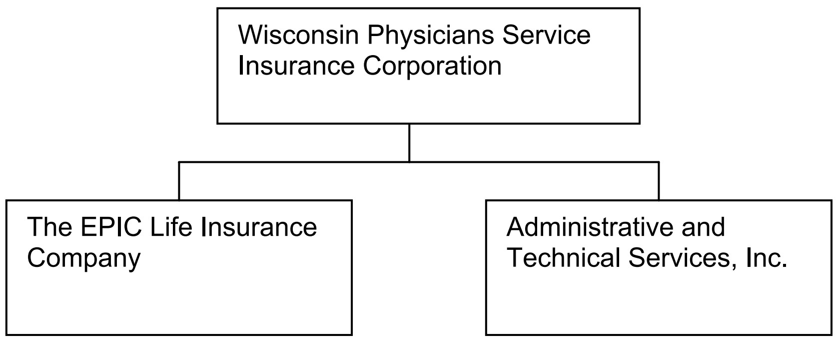
Finance Committee
Edwin Hill, Jr, Chair
Leland Kauth
Brad Anderson
William Bathke
James Riordan
Eugene Nordby, MD
Marla Ahlgrimm, RPH
John Brandaubur, MD

Planning Committee
David Vogel, Chair
Marvin Brickson
John McGloin, MD
John Matthews
Brad Anderson
Jeffrey Allen, MD
Eugene Nordby, MD
Timothy Flaherty, MD

IV. AFFILIATED COMPANIES

Wisconsin Physicians Service Insurance Corporation (WPS) is the parent of a holding company system. The organizational chart below depicts the relationships among the affiliates in the group. A brief description of the significant affiliates of WPS follows the organizational chart.

Organizational Chart
As of December 31, 2001



The EPIC Life Insurance Company (EPIC)

EPIC is a wholly owned subsidiary stock corporation of WPS whose primary business is group life, dental, vision, and disability insurance as well as voluntary insurance on the same product portfolio. EPIC was established in 1984 primarily to write business in other states. As of December 31, 2001, the company's audited financial statement reported assets of $26,055,368, liabilities of $7,677,703, and capital and surplus of $18,377,665. Operations for 2001 produced net income of $1,106,479. An examination of EPIC was performed in conjunction with the examination of WPS. A separate report has been issued on the examination of EPIC.

Administrative and Technical Services, Inc. (Adtec)

This company is a wholly owned subsidiary stock corporation of WPS incorporated September 19, 1979. It specializes in providing office and light industrial temporary personnel, and contract programming services. As of December 31, 2001, the company’s audited financial statements reported assets of $3,072,288, liabilities of $228,854, and total equity of $2,843,434. Operations for 2001 produced a net loss of $222,306.

Affiliated Agreements

WPS has tax-allocation agreements with EPIC and Adtec. In addition, WPS and EPIC have a service and supplies agreement, under which WPS provides management, investment, administrative, and other services and supplies. EPIC annually pays WPS a mutually agreed upon reasonable amount for general management services and overhead costs associated with incidental items used by company personnel in providing the required services and supplies. For all other services provided, except for investment services, EPIC shall reimburse WPS for the actual cost of the services provided. For investment services, WPS receives one-eighth of one percent of the value of investment portfolio at each quarter end. WPS and Adtec have a similar service and supplies agreement.

V. REINSURANCE

The company's major reinsurance treaties in force at the time of the examination are summarized below. The contracts contained proper insolvency provisions.

Retrocession Contract

Under this agreement, WPS assumes group medical business written by Security Life Insurance Company of America and Congress Life Insurance Company up to December 31, 1997 and from 1998 to present from Massachusetts General Life Insurance Company (now known as Conseco Life Insurance Company) which is administered by Corporate Benefits Services of America, Inc. (CBSA). WPS than retrocedes this business 100% to EPIC, except that WPS is responsible for any losses if the loss ratio on the business exceeds 71%.

Affiliated Assuming Contracts

The company assumes under a quota share from its affiliate, The EPIC Life Insurance Company (EPIC), accident and health coverage administered by the home office and defined as CORE business. WPS assumes 100% of the results on this business.

Non-Affiliated Assuming Contracts

The company has a joint venture agreement with Delta Dental Plan of Wisconsin (Delta). Part of this agreement is a reinsurance contract whereby WPS covers 100% of the old group dental business issued by WPS and then transferred to Delta policy forms with initial effective dates prior to January 1, 1996. Effective January 1, 1996, WPS also covers 50% of the new group dental plans solicited by WPS and written on Delta policy forms.

Non-Affiliated Ceding Contracts

The company has three excess of loss contracts with American National Insurance Company. The contracts cover Corporate Benefits Services of America (CBSA) business, excess of loss for the self-funded business and former North Central Health Protection Plan (NCHPP) business. The basic coverage for CBSA business is $2,850,000 over a retention of $150,000. WPS's reinsurance on its stop loss coverage on self-funded groups covers $2,900,000 over a retention of $100,000. The NCHPP coverage is $1,850,000 over a retention of $150,000.

Continental Assurance Company (CNA) began covering the excess of loss for the WPS Health Care Benefit Plan effective July 1, 2001. The coverage is $1,850,000 in excess of a retention of $150,000.

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 2001, annual statement to the Commissioner of Insurance. Also included in this section are schedules which reflect the growth of the company, NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination, and the compulsory and security surplus calculation. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Surplus per Examination."

Wisconsin Physicians Service Insurance Corporation
Assets
As of December 31, 2001

	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds	$47,337,830	$	$ 47,337,830
Stocks:			
Common stocks	37,136,961		37,136,961
Real estate:			
Occupied by the company	27,155,738		27,155,738
Cash	(12,846,365)		(12,846,365)
Short-term investments	23,651,697		23,651,697
Accident and health premiums due and unpaid	1,796,601	90,977	1,705,624
Health care receivables	3,741,184	838,505	2,902,679
Amounts recoverable from reinsures	1,249,484		1,249,484
Investment income due and accrued	814,664		814,664
Amounts due from parent, subsidiaries and affiliates	811,771		811,771
Amounts receivable relating to uninsured accident and health plans	19,251,979	103,769	19,148,210
Furniture and equipment	5,208,811	5,208,811	
Federal and foreign income tax recoverable and interest thereon	39,631		39,631
Electronic data processing equipment and software	3,358,221	1,617,672	1,740,549
Other assets nonadmitted:			
Leasehold improvements	1,450,002	1,450,002	
Write-ins for other than invested assets:			
Miscellaneous accounts receivable	508,213	508,213	
Prepaid expenses	800,532	800,532	
Deferred charges	898,561	898,561	
Prepaid pension	5,351,709	5,351,709	
Capitalized application software	726,496	726,496	
Total Assets	$168,443,720	$17,595,247	$150,848,473

Wisconsin Physicians Service Insurance Corporation
Liabilities, Surplus, and Other Funds
As of December 31, 2001

Claims unpaid	$ 40,647,185
Accrued medical incentive pool and bonus payments	394,633
Unpaid claims adjustment expenses	14,594,263
Aggregate policy reserves	7,896,253
Premiums received in advance	8,122,756
General expenses due or accrued	13,380,356
Federal and foreign income taxes	232,684
Amounts withheld or retained for the account of others	225,266
Amounts due to parent, subsidiaries and affiliates	51,034
Funds held under reinsurance treaties with authorized reinsurers	1,820,704
Liability for amounts held under uninsured accident and health plans	668,504
Aggregate write-ins for other liabilities:	
Remittances and items not allocated	3,421,804
Reserve for escheatable items	275,559
Total Liabilities	91,731,001
Surplus	59,117,472
Total Liabilities, Surplus, and Other Funds	$150,848,473

Wisconsin Physicians Service Insurance Corporation
Statement of Revenue and Expense
For the Year 2001

Member Months	1,264,114	
Net premium income		$275,621,806
Change in unearned premium reserves and reserve for rate credits		(801,852)
Total revenues		274,819,954
Medical and Hospital		
Hospital/medical benefits		157,615,461
Other professional services		2,686,554
Emergency room and out-of-area		65,720,925
Incentive pool and withhold adjustments		394,633
Subtotal		226,417,573
Less:		
Net reinsurance recoveries		(3,608,851)
Total medical and hospital		230,026,424
Claims adjustment expense		20,880,241
General administrative expenses		24,587,287
Total underwriting deductions		275,493,952
Net underwriting gain or (loss)		(673,998)
Net investment income earned		5,311,617
Net realized capital gains or (losses)		(226,567)
Net investment gains or (losses)		5,085,050
Aggregate write-ins for other income or expense		597,567
Net income or (loss) before federal income taxes		5,008,619
Federal and foreign income taxes incurred		(553,288)
Net income		$ 5,561,907

Wisconsin Physicians Service Insurance Corporation
Cash Flow
As of December 31, 2001

Cash from operations			
Premiums and revenues collected net of reinsurance	$275,885,206		
Claims and claims adjustment expenses	236,717,590		
General administrative expenses paid	28,734,306		
Cash from underwriting	10,433,310		
Net investment income	5,392,213		
Other income	597,567		
Federal and foreign income taxes recovered	469,657		
Net cash from operations		$ 16,892,747	
Cash from Investments			
Proceeds from investments sold, matured or repaid:			
Bonds	33,374,124		
Stocks	15,156,863		
Miscellaneous proceeds	4,007,844		
Total investment proceeds	52,538,831		
Cost of investment acquired:			
Bonds	33,860,061		
Stocks	16,893,245		
Real Estate	11,025,170		
Total investments acquired	61,778,476		
Net cash from investments		(9,239,645)	
Cash from Financing and Miscellaneous Sources			
Cash Provided:			
Net transfers from affiliates	290,225		
Other cash provided	3,929,786		
Total	4,220,011		
Net cash from financing and miscellaneous sources		4,220,011	
Net change in cash and short-term investments			$11,873,113
Reconciliation			
Cash and short-term investments, December 31, 2000			(1,067,781)
Cash and short-term investments, December 31, 2001			$10,805,332

Wisconsin Physicians Service Insurance Corporation
Compulsory and Security Surplus Calculation
December 31, 2001

Assets		$150,848,473	
Add Medicare and TRICARE assets admitted per OCI		4,351,194	
Less security surplus of insurance subsidiaries		2,800,000	
Less liabilities		91,731,001	
Adjusted surplus			$60,668,665
Less amount of foreign investments in excess of basket clause			(10,082,747)
Less examination adjustments			(156,679)
Adjusted Surplus per examination			50,429,239
Annual premium:			
Individual life and health	$ 58,210,923		
Factor	15%		
Total		8,731,638	
Group life and health	209,336,975		
Factor	10%		
Total		20,933,698	
Compulsory surplus (subject to a $2,000,000 minimum)			29,665,336
Compulsory surplus excess or (deficit)			$20,763,903
Adjusted surplus per examination			$50,429,239
Security surplus: (140% of compulsory surplus, factor reduced 1% for each $33 million in premium written in excess of $10 million with a minimum of 110%)			39,454,897
Security surplus excess or (deficit)			$10,974,342

Wisconsin Physicians Services Insurance Corporation
Reconciliation and Analysis of Surplus
For the Five-Year Period Ending December 31, 2001

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999	2000	2001
Capital and surplus, beginning of year	$ 82,451,116	$ 62,892,447	$ 58,237,222	$ 66,384,639	$ 60,758,656
Net income	(22,017,313)	(4,695,567)	6,461,229	3,693,371	5,561,907
Change in net unrealized capital gains or (losses)	767,849	1,311,232	2,392,457	(3,937,789)	(1,170,493)
Change in net deferred income tax					(232,684)
Change in non-admitted assets and related items	1,690,795	(1,270,890)	(706,269)	(5,381,565)	(3,864,828)
Cumulative effect of changes in accounting principles					(1,935,086)
Capital and surplus, end of year	$ 62,892,447	$ 58,237,222	$ 66,384,639	$ 60,758,656	$ 59,117,472

Growth of Wisconsin Physicians Services Insurance Corporation

Year	Admitted Assets	Liabilities	Surplus
1997	$155,895,728	$93,003,281	$62,892,447
1998	146,817,511	88,580,289	58,237,222
1999	141,365,424	74,980,785	66,384,639
2000	142,083,349	81,324,693	60,758,656
2001	150,848,473	91,731,001	59,117,472

Year	Net Premiums Earned	Claims Incurred	Net Underwriting Gain/Loss	Net Income
1997	$311,890,626	$281,431,266	$(41,818,748)	$(22,017,313)
1998	245,400,900	207,551,585	(20,773,131)	(4,695,567)
1999	197,783,509	162,423,264	(179,097)	6,461,229
2000	217,496,329	185,339,855	(6,436,011)	3,693,371
2001	274,819,954	230,026,424	(673,998)	5,561,907

Operating Percentages (Percent of Premiums Earned)

Year	Claims Incurred	Expenses	Total
1997	90.2%	23.2%	113.4%
1998	84.6%	23.9%	108.5%
1999	82.1%	18.0%	100.1%
2000	85.2%	17.8%	103.0%
2001	83.7%	16.5%	100.2%

Since the prior examination as of 1996, assets decreased from $180,879,882 to $150,848,473 and net worth decreased from $82,451,116 to $59,117,472 or 16.6% and 28.3% respectively. The company has reported a positive net income for the past three years. The company's net premiums earned have decreased approximately 11.9% over the period under examination. The company's combined ratio was over 100% for all five years. The company's combined ratio was over 100% for all five years, improving from 113.4% in 1997 to 100.2% in 2001.

The company's surplus decreased each year under review, with the exception of 1999 when the surplus increased over $8 million. The decrease in surplus in 2001 is due to net unrealized capital losses of $1.2 million and codification changes of ($5.8 million). The net change in capital and surplus for 2001 is ($1,641,184).

Reconciliation of Surplus per Examination

The following schedule is a reconciliation of surplus between that reported by the company and as determined by this examination:

Surplus December 31, 2001, per annual statement			$59,117,472
	Increase	**Decrease**	
Bonds	$	$156,679	
Net (decrease)	$	$156,679	(156,679)
Surplus December 31, 2001, per examination			$58,960,793

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were four specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. <u>Amounts Receivable Relating to Uninsured Accident and Health Plans</u>—It is recommended that in future annual statements, the company report premium receivable on stop-loss coverage as uncollected premiums in accordance with the NAIC <u>Annual Statement Instructions</u>.

   <u>Action</u>—Compliance.

2. <u>Electronic Data Processing Equipment</u>—It is recommended that in future annual statements, the company not include telephone equipment in EDP equipment.

   <u>Action</u>—Compliance.

3. <u>Premium Deposits</u>—It is again recommended that the company properly classify amounts received with applications as premium deposits in accordance with the NAIC <u>Annual Statement Instructions</u>.

   <u>Action</u>—Compliance.

4. <u>Remittances and Items Not Allocated</u>—It is recommended that the company perform a reconciliation of this liability at least quarterly.

   <u>Action</u>—Compliance.

Summary of Current Examination Results

Accounts and Records

During the review of Remittances and Items Not Allocated the examination noted that supporting documentation for part of the balance was not retained by the company. The examination also noted that some copies of directors' conflict of interest statements could not be produced. It is recommended that the company retain conflict of interest statements and records that support balances pursuant to s. Ins 6.80 (4), Wis. Adm. Code.

Executive Compensation

The examination review of the Report on Executive Compensation (Form OCI-040) for 2000 noted that the form is not being completed correctly. The review of the compensation amounts being reported indicated that amounts contributed by the company in connection with the Supplemental Executive Retirement Plan (SERP) were not included on Form OCI-040 for executives that participate in SERP. It is recommended that the company properly include all compensation amounts paid or accrued for when completing the Report on Executive Compensation (Form OCI-040).

Bonds

The company incorrectly reported $561,590 for the par value of a bond on the annual statement in which the trust statement had a par value of $500,000. The company had explained they used a calculation to find the par value of the security. The par value does not change due to the price paid or the price at the end of the year. The par amount should be the amount of principal to which the reporting entity has a claim. It is recommended that the company correctly state par value as the par amount of principal to which the reporting entity has a claim in accordance with the NAIC Annual Statement Instructions – Health.

According to SSAP No. 26, paragraph 7, for reporting entities that maintain an Asset Valuation Reserve (AVR), bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, bonds that are designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; with all other bonds (NAIC designations 3 to 6) reported at the lower of amortized cost or fair value. The company valued bonds rated NAIC 3 and 4 at amortized value even though the company does not maintain an AVR. An adjustment decreasing surplus by $156,679, the difference between book value and market value, was made in the section of this report entitled “Reconciliation of Surplus per Examination.” It is recommended that the company comply with SSAP No. 26, paragraph 7 and report bonds that are NAIC designations 3 to 6 at the lower of amortized cost or fair value.

There were two securities on the company's 2001 annual statement labeled with a "Z" designation that were acquired more than 120 days prior to year end 2001. One of the securities was found to have a "W" designation on the NAIC Securities and Valuation Office (SVO) diskette in 2001, meaning that the security was found to have ratings from two nationally recognized statistical rating organizations (NRSRO). In this case, the company should have designated the security as provisionally exempt (PE), rather than as a "Z". The other security that was listed as a “Z” had an incorrect CUSIP number (see below for further explanation of incorrect CUSIP numbers). When using the correct CUSIP number, the security was found to have an SVO designation of “2”. It is recommended that the company comply with the Purposes and Procedures Manual of the NAIC Securities Valuation Office and report correct designations for each security on future annual statements.

The company does not have a formal policy for monitoring provisionally exempt (PE) designated securities. The company takes the designations from the quarterly SVO diskettes. According to Part Four, Section (1)a of the Purposes and Procedures Manual of the NAIC Securities Valuation Office it is the responsibility of the insurer to maintain documentation that the PE securities meet the exemption criteria. Since the company does not monitor the PE securities, the company may not be filing with the SVO securities that have lost there PE status within 120 days of failure to meet conditions set for PE designations. It is recommended that the company comply with the Purposes and Procedures Manual of the NAIC Securities Valuation Office and maintain documentation for provisionally exempt designation securities and make sure that any securities that no longer qualify for the provisionally exempt designation be filed within 120 days of such failure, as if the securities had never been provisionally exempt.

The company relies on their custodian for the CUSIP numbers they report. The examiners noted that for one bond, the CUSIP number listed by the company's custodian did not match the SVO's listing. It is recommended that the company comply with NAIC Annual Statement Instructions – Health, and report CUSIP numbers that conform to those published by the SVO.

Short Term Investments

The company had a $20,642,140 investment at December 31, 2001 in a Eurodollar Sweep Account. The Eurodollar Sweep account is in an account in a Cayman Islands branch of a U.S. bank. The company indicated during the examination that it does not consider it to be a foreign bank account but rather a U.S. bank account, and has not disclosed it as a foreign bank account in its' annual statement or IRS tax returns, or adjusted for it in the compulsory surplus calculation. The foreign bank account exceeds the company's internal investment guidelines for foreign investments. In addition, under Ins. 6.20 (8)(k), Wis. Adm. Code, foreign investments that may be counted for compulsory and security surplus are limited to two percent of admitted assets. Since the company has no business in foreign countries that would require the use of foreign bank accounts, the company should reevaluate whether the use of the foreign bank account is warranted It is recommended that the company comply with s. Ins 6.20 (8)(k), Wis. Adm. Code, in which foreign investments are limited to 2% of admitted assets.

Derivatives

In accordance with the NAIC Annual Statement Instructions – Health, the Underwriting and Investment Exhibit Part 4A-Capital Gains and (Losses) on Investments, Line 7-Derivative Instruments should include capital gains or (losses) from Schedule DB. The company is reporting the capital gain from their hedge (Schedule DB) on the Aggregate write-ins for capital gains and (losses), line 8. It is recommended that the company put capital gains or (losses) from Schedule DB on Line 7 of the Underwriting and Investment Exhibit Part 4A in accordance with the NAIC Annual Statement Instructions – Health.

Unpaid Claim Adjustment Expenses

The unpaid claim adjustment expenses reported by the company as of December 31, 2001 was $14,594,263. The Company's actuary only opined on the actuarially determined reserve amount of $1,537,320. The balance of $13,056,943 was for expenses, which the company had incurred as of the valuation date for processing claims, which had not yet been paid. The actuarial opinion should opine on all annual statement amounts reported as unpaid claims adjustment expenses. It is recommended that the actuary opine on the entire balance of unpaid claims adjustment expenses according to the NAIC Annual Statement Instructions – Health.

Special Deposits

The examination noted that the company had $3,080,350 of state deposits and $11,313,645 of deposits pledged as collateral for reinsurance and lease agreements on Schedule E Part 2. The company mislabeled all of the securities in Schedule E Part 2 as being "special deposits not held for the benefit of all policyholders, claimants, and creditors of the company". The state deposits should have been labeled as "special deposits held for the benefit of all policyholders, claimants, and creditors of the company." It is recommended that the company correctly fill out Schedule E Part 2 Special Deposits in accordance with the NAIC Annual Statement Instructions – Health.

VIII. CONCLUSION

This examination resulted in one adjustment to write down investments designated 3 through 6 to the lower of amortized cost or fair value. This examination made recommendations on proper reporting of investments, discontinuing the use of a foreign bank account, properly fill out Exhibit 4A, and properly fill out Schedule E. Since the prior examination, as of 1996, assets and net worth have decreased by 3.2% and 6%, respectively. The company has reported a net income in each of the last three years. The company complied with all of the prior examination recommendations.

The company's surplus decreased each year under review, with the exception of 1999 when the surplus increased approximately $8 million. The decrease in surplus in 2001 is due to, net unrealized capital losses of $1.2 million and codification changes of ($5.8 million). The net change in capital and surplus for 2001 is ($1,641,184). The company's net premiums earned decreased approximately 11.6% over the period under examination. The company's combined ratio was over 100% for all five years, improving from 113.4 in 1997 to 100.2 in 2001.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 21 - Accounts and Records—It is recommended that the company retain conflict of interest statements and records that support balances pursuant to s. Ins 6.80 (4), Wis. Adm. Code.

2. Page 21 - Executive Compensation—It is recommended that the company properly include all compensation amounts paid or accrued for when completing the Report on Executive Compensation (Form OCI-040).

3. Page 21 - Bonds— It is recommended that the company correctly state par value as the par amount of principal to which the reporting entity has a claim in accordance with the NAIC Annual Statement Instructions – Health.

4. Page 22 - Bonds—It is recommended that the company comply with SSAP No. 26, paragraph 7 and report bonds that are NAIC designations 3 to 6 at the lower of amortized cost or fair value.

5. Page 22 - Bonds—It is recommended that the company comply with the Purposes and Procedures Manual of the NAIC Securities Valuation Office and report correct designations for each security on future annual statements.

6. Page 22 - Bonds—It is recommended that the company comply with the Purposes and Procedures Manual of the NAIC Securities Valuation Office and maintain documentation for provisionally exempt designation securities and make sure that any securities that no longer qualify for the provisionally exempt designation be filed within 120 days of such failure, as if the securities had never been provisionally exempt.

7. Page 23 - Bonds—It is recommended that the company comply with NAIC Annual Statement Instructions – Health, and report CUSIP numbers that conform to those published by the SVO.

8. Page 23 - Short Term Investments— It is recommended that the company comply with s. Ins 6.20 (8)(k), in which foreign investments are limited to 2% of admitted assets.

9. Page 23 - Derivatives— It is recommended that the company put capital gains or (losses) from Schedule DB on Line 7 of the Underwriting and Investment Exhibit Part 4A in accordance with the NAIC Annual Statement Instructions – Health.

10. Page 24 - Unpaid Claim Adjustment Expenses—It is recommended that the actuary opine on the entire balance of unpaid claims adjustment expenses according to the NAIC Annual Statement Instructions – Health.

11. Page 24 - Special Deposits—It is recommended that the company correctly fill out Schedule E Part 2 Special Deposits in accordance with the NAIC Annual Statement Instructions – Health.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers and employees of the company are acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination:

Name	Title
David A Grinnell	Insurance Financial Examiner
DuWayne A Kottiwtz	Insurance Financial Examiner
Jean M Suchomel	Insurance Financial Examiner
Sarah M Haeft	Insurance Financial Examiner

Respectfully submitted,

Kerri L Miller
Examiner-in-Charge